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Review of the efficiency of the administrative and financial functioning of the United Nations

Report of the Secretary-General on the activities of the Office of Internal Oversight Services

Report of the Office of Internal Oversight Services on the audit of the commercial insurance programmes

Note by the Secretary-General

1. Pursuant to General Assembly resolution 48/218 B of 29 July 1994 and decision 51/468 B of 13 June 1997, the Secretary-General has the honour to transmit, for the attention of the General Assembly, the attached report, conveyed to him by the Under-Secretary-General for Internal Oversight Services, on the audit of the commercial insurance programmes.

2. The Secretary-General takes note of its findings and concurs with its recommendations.

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Report of the Office of Internal Oversight Services on the audit of the commercial insurance programmes

Summary

At the General Assembly's request, the Office of Internal Oversight Services has conducted an audit of the Organization's commercial insurance arrangements, not including the global cargo and motor vehicle policies, which were included in a 1995 review (A/51/302). In 1997, expenditures on these insurance arrangements totalled more than $1.5 million.

A. Results in brief

Insurance coverage has evolved historically, not as a result of a strategic approach to managing risk exposure. The Organization relies too heavily on its brokers. The Insurance Section is inappropriately structured and under-resourced. Specifically, the Office of Internal Oversight Services found that:

- No risk assessment for the foreign property and demining liability policies had been performed;
- There were limitations in the competitive bidding process for establishing and renewing foreign property coverage;
- No asset valuation methodology for insurance purposes existed;
- The Insurance Section's handling of foreign coverage was limited to United Nations premises in Addis Ababa, Beirut and Santiago de Chile. Little guidance was provided to offices away from Headquarters, nor did standardized coverage criteria exist;
- Funds to cover liability claims at Headquarters are sufficient to merit examination of alternatives to the annual allocation.

B. Recommendations

To address the shortcomings disclosed by the audit, the Office of Internal Oversight Services recommends:

- Development and implementation of an Organization-wide policy on risk management, including specifications and guidelines for all United Nations property policies worldwide;
- Relocation of the responsibility for commercial insurance to the Office of Central Support Services and the allocation of additional resources;
- Performance of comprehensive risk assessments of both the foreign property and demining liability programmes;

- Launching a comprehensive broker competition exercise, specifying service requirements, combining Headquarters and foreign property policies and adding locations such as the United Nations Logistics Base in Brindisi;
- Definition of a valuation methodology for insurance purposes;
- Performance of an assessment of the self-insurance fund with a view to eliminating or reducing the annual allocation of $200,000.

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I. Introduction

1. In 1995, the Office of Internal Oversight Services conducted a management audit of the global cargo and worldwide motor vehicle insurance policies. The resulting report was submitted to the General Assembly at its fifty-first session (A/51/302). Pursuant to General Assembly decision 51/468 B, the Office of Internal Oversight Services performed a further similar audit covering other United Nations insurance programmes and including the question of insurance contracts based on international bidding. In view of the functional differences between health insurance and the commercial insurance arrangements, two separate reports are submitted to the General Assembly.

2. The present report includes the audit results on the policies covering:

(a) Headquarters property;

(b) Foreign property (in four separate locations);

(c) Aviation liability;

(d) Demining liability.

Annual premiums for these policies in 1997 amounted to more than $1 million. The Office of Internal Oversight Services also reviewed the administration and status of the self-insurance fund for general liability claims at Headquarters. The annual allocation to this fund was set at $200,000. The Office of Internal Oversight Services also surveyed insurance policies maintained by the United Nations Offices at Geneva, Vienna and Nairobi, as well as by the Economic and Social Commission for Asia and the Pacific (ESCAP) and the International Tribunals for the Former Yugoslavia and Rwanda to establish the level of premiums for policies taken out independently of Headquarters. In 1997, these premiums totalled approximately $340,000.

3. Not included in the audit were:

(a) The global cargo and worldwide motor vehicle policies already reviewed;

(b) Additional commercial policies covering the vehicle fleet at Headquarters, the boiler and machinery, travel accidents, rifle range liability, foreign general liability, special events and terrorism risks against overseas property, which did not warrant detailed review owing to the low level of individual premiums;

(c) The policy providing protection against malicious acts at hazardous duty stations, which is administered by the Office of the United Nations Security Coordinator owing to the system-wide nature of the coverage.

4. The Insurance Claims and Compensation Section, within the Office of Programme Planning Budget and Accounts (Insurance Section), at Headquarters, is responsible for establishing, administering and monitoring commercial insurance coverage for the United Nations.

5. The audit sought to determine whether the Organization had established and administered its insurance arrangements in a coherent and efficient manner and effectively managed its exposure to risk and potential liabilities. The audit was conducted from October to December 1997 at United Nations Headquarters in accordance with the Standards for the Professional Practice of Internal Auditing in the United Nations Organizations. Findings and recommendations were discussed with the Insurance Section in February 1998. The Office of Internal Oversight Services submitted a draft of the report to the Department of Management on 3 March 1998. Comments from the Department, received on 13 April 1998, have been taken into account and, where appropriate, are shown in italics.

II. Risk management

6. Risk management includes, but is not limited to, analysing and mitigating an organization's exposure to loss, developing appropriate risk finance techniques and arranging and overseeing insurance protection.

7. The Office of Internal Oversight Services believes that the Organization requires a more cohesive, clearly defined approach to managing its risk exposure. The review showed that the Insurance Section relies too much on its external brokers. The Office is not convinced that the Organization's package of risks is always accurately and competitively presented to underwriters. The development of insurance coverage has frequently occurred in an ad hoc manner rather than as a result of a centrally defined strategic approach to risk management. The Office also found that the function of risk management was poorly defined. *The Department of Management pointed out that "the demanding and increasingly complex area of risk management and commercial insurance has been handled by a very small office, with other major responsibilities".*

8. Indeed, the increase in the United Nations peacekeeping and humanitarian assistance activities has been coupled with a rise in the Organization's exposure to an array of risks and potential liabilities. Examples include the

liability arising from potential accidents involving aircraft deployed to peacekeeping missions and demining operations in the field. According to the principal insurance broker for the Organization, the United Nations package of commercial insurance policies and premium levels rank it as a medium to large-sized client, equivalent to that of a small Fortune 500 multinational corporation. Nevertheless, the Office of Internal Oversight Services wishes to reiterate that the Organization should take a more proactive approach to risk management. The Department of Management's response to the draft audit report confirmed in several instances that the Insurance Section's approach to protecting the Organization's interests is indeed reactive. The Office acknowledges that a change in approach would require additional resources (see sect. III below).

A. The relationship with insurance brokers

9. Most organizations requiring insurance coverage do not approach the underwriting community directly, but instead use the expertise of brokers to present the "package" of particular risks from which protection is sought, survey the market and select the most appropriate underwriter(s). By representing a large range of clients and a diverse spread of risks, brokerage firms are better placed to negotiate with underwriters, since they have greater leverage in achieving favourable policy conditions and premium rates.

10. In this sense, seeking insurance coverage does not follow the typical pattern for the procurement of goods or services. The need to establish an ongoing relationship of mutual trust and cooperation with a broker is a key factor if an organization is to protect its interests and assets in an economical and effective manner. Common wisdom dictates that frequent changes of brokers can limit prospects of obtaining a thorough understanding of an organization's specific risk profile and also restrict the possibility of achieving premium savings based on a favourable claims history.

11. Nevertheless, it cannot be automatically assumed that a broker will act in the best interests of its client. An organization must actively control how and to what extent the risks to its assets should be absorbed, self-insured, transferred to contractors or underwritten by insurers. This requires close coordination with a broker as well as careful determination of the way risks are presented to the underwriters. Each approach to the market requires a predetermined strategy – the result of a collaborative effort by both the Insurance Section and the broker. While the broker is responsible for continuously monitoring the market for improved terms and conditions, the Insurance Section should ensure that the broker adequately performs these tasks. The value added by both parties will depend on the combined use of their expertise to properly protect the Organization's interests and assets.

12. The Office of Internal Oversight Services found that the Insurance Section had too heavily delegated its risk management responsibilities to the Organization's insurance brokers. In the absence of documentation, the auditors were not able to verify:

(a) How risks were identified;

(b) How coverage limits were determined and quantified;

(c) Whether the best way was chosen of presenting the risks to the market to achieve maximum coverage at a reasonable price.

13. In particular, the Office of Internal Oversight Services made the following observations:

(a) The Insurance Section could not confirm how the various risk profiles were "sold" to the insurance market, since the brokers were not required to forward copies of the requests for proposals sent to prospective underwriters at the time of bidding or renewing coverage. Therefore, the Section could not confirm whether this corresponded to a predetermined strategy for each of the major commercial policies. At no time in the bidding or post-bid negotiation period did any of the Insurance Section personnel attend meetings between the broker and the potential underwriters. Instead, brokers forwarded a list of the companies contacted, copies of any declination letters and details of any bids received. The Office of Internal Oversight Services is pleased to note that, as a result of the audit, brokers are now required to furnish copies of marketing documents prepared for each solicitation;

(b) No pre-underwriting audits or inspections have been undertaken by either the major policy brokers or any of the prospective underwriters. Three of the foreign locations had not been physically inspected within the last 10 years by either the broker or underwriter representatives. The Headquarters complex had only been inspected by the existing lead underwriter. Since 1993, no assessment of the building's security arrangements has been made, an important consideration in determining the risk of terrorist acts. In the case of the demining programme in Mozambique, no comprehensive assessment of the Organization's exposure to liability has ever been performed by the broker, and the premium has not been revised since its inception in 1994.

The Department of Management stated that the insurers were "satisfied with the information provided to them [the insurers] in the 1993 security briefing and inspection". However, the Insurance Section was not aware of the nature of findings, until the broker furnished a copy of the relevant report in response to the auditor's request. Indeed, the insurer's report did express several major reservations concerning the level of security at United Nations Headquarters, which continue to remain unaddressed and may adversely affect the level of the insurance premiums;

(c) The details of the brokers' commissions are not disclosed in most of the policy documents and were therefore not known to the Insurance Section. Thus, this information could not be presented to the Headquarters Committee on Contracts. Consequently, the auditors were not able to determine whether it might be in the Organization's interests to negotiate an overall flat charge for certain policies rather than commissions based on premiums. Further, there has never been any analysis of whether the commissions are competitive and whether the services provided by brokers justify the level of commission;

(d) None of the major policy documents contained any requirement for either the broker or the underwriter to provide the United Nations with periodic stewardship reports, formally communicating the changes in the insurance and reinsurance markets and the prospects for improving terms, demonstrating how the Organization's interests are being protected and providing general advice on refinements to the risk management strategy. Such reports are standard practice in the industry. *The Department of Management stated that meetings were held two or three times a year between the Insurance Section and the broker*. However, The Office of Internal Oversight Services noted that these discussions had not been documented.

B. The Insurance Section as a centralized focal point

14. It appears that the function of risk management has been haphazardly de-centralized across the Organization, despite the existence of a centralized focal point for insurance policy matters at United Nations Headquarters. The review indicated that United Nations Headquarters had virtually no data relating to the insurance coverage for the Organization's property in Geneva, Vienna, Nairobi, Bangkok and at the International Criminal Tribunals even though the Chief of the Insurance Section, according to his job description, is "the focal point for policy formulation" in the Organization. With the exception of ESCAP in Bangkok, procurement officers in the above-listed locations were responsible for securing their own insurance coverage, without guidance or assistance from the Insurance Section at Headquarters in determining liability limits, acceptable deductible levels and types of coverage. For the purposes of the present review, the auditors had to survey each of the individual offices concerned in order to obtain this information for benchmarking purposes.

15. At the same time, the foreign property insurance policy administered by Headquarters does not include the Organization's property mentioned in the above locations. Instead, the coverage is for the Organization's property in Addis Ababa, Beirut and Santiago de Chile, as well as for the premises of the United Nations Development Programme (UNDP) in Nepal.

16. As a result, no standardized policy in risk retention and management had been developed across the Organization. The Insurance Section informed the Office of Internal Oversight Services that the objective was to achieve the maximum level of catastrophe coverage for the lowest possible premium, given budgetary constraints. However, the Office believes that more specific guidance is required. The following examples demonstrate other concerns:

(a) The deductible level for the property claims at Headquarters was $100,000, meaning that most property losses could never be claimed. However, this limit had not been established on the basis of a comparison with actual property losses. *The Department of Management informed the Office of Internal Oversight Services that a lower deductible option had been examined and was considered not to be cost-effective*. In the absence of any property loss data, the basis for this decision cannot be determined;

(b) The term for the Headquarters property policy is three years, whereas the foreign property coverage is currently sent out for bid annually. *The Department of Management maintained that it had been clearly advantageous to have annual renewals for the foreign property policy*. However, no analysis had been done to determine the ideal policy length in each case, nor did it appear that underwriters were given the option to propose alternative durations;

(c) In certain offices away from Headquarters, buildings were covered by one policy, while contents, such as electronic data-processing equipment, were insured under a separate policy, with different deductible levels.

17. The Office of Internal Oversight Services acknowledges that the nature of risks and legal requirements

do differ according to location, which may partially justify a decentralized approach. However, this does not preclude the establishment of clear guidelines and coverage criteria in order to ensure a degree of consistency across the Organization, as well as economies of scale. Furthermore, the Organization is not currently able to know whether a global "all-risk" property policy might be more economical, since this has never been proposed to the brokers and underwriters.

C. Proactive initiatives

18. The Office of Internal Oversight Services believes that the Insurance Section could have taken a more proactive approach to the Organization's need to protect itself from external risks and potential liabilities. The position of risk manager, according to one generic job description provided by industry sources, includes responsibility for supervising corporate policy in risk retention and management, fire protection, security and personnel safety. Additional duties include collaborating with other departments in developing insurable values of property and preparing periodic reports to senior management on how an organization's assets and resources are being protected. The Insurance Section at the United Nations does not currently perform such functions nor does the official job description for the Chief require the incumbent to be proactive in the ways described. In particular, the following instances demonstrate where more initiative would have been desirable:

(a) No coverage had been sought to insure the materials and equipment at the United Nations Logistics Base in Brindisi against catastrophic damage. Estimates of the valuation of this inventory range from $20-$49 million, although a more precise estimate of the depreciated value is expected in 1998, with the implementation of a global asset management system by the Department of Peacekeeping Operations. *The Department of Management stated that "bearing in mind that similar equipment at peacekeeping missions ... is not commercially insured, the Department of Peacekeeping Operations did not formally request such coverage and the matter was not further pursued by ICCS".* Nevertheless, the Office of Internal Oversight Services understood that the underlying reason for not insuring property in the missions was the prohibitive cost of coverage in war-torn locations. This is not the case for equipment stored in Brindisi;

(b) The Insurance Section could not confirm the method used for determining the values of either Headquarters or foreign property. Given that the property valuations directly determine the level of the premium, the broker's commission, and the limitation of the underwriter's liability, the establishment of an appropriate valuation methodology for insurance purposes should be of fundamental concern to the Insurance Section;

(c) In the case of demining liability insurance, the Insurance Section *"was tasked to act speedily on a requirement identified by the substantive and legal offices in regard to an urgent project with a high political profile".* Since that time, however, no risk assessment has been performed nor a determination of how the programme in question differed from other previous demining efforts, in that the Organization could now be held liable for third party claims. No measures to renegotiate or re-bid the demining liability policy have been taken, despite the high cost of the premium ($81,326 in 1997);

(d) The level of the self-insurance reserve fund for general liability claims at Headquarters had not been assessed since its inception in 1987 (see sect. VIII below);

(e) The possibility of requesting brokers to solicit bids from underwriters for a combined foreign and Headquarters "all-risk" property policy was only proposed in response to a request made in September 1997 by the new Executive Coordinator for Common Services to identify reform possibilities within the arena of common services. The Office of Internal Oversight Services believes that the combination of these lines could make the risk "package" more attractive to underwriters, since the exposures would be spread across a wider spectrum of locations and risk profiles. The Office of Internal Oversight Services is pleased to note that the Department of Management intends to embark on this exercise.

19. The Office of Internal Oversight Services also noted that the Insurance Section has no affiliation or membership with professional societies monitoring developments and changes in the commercial insurance arena, such as the Risk and Insurance Management Society and the International Risk Management Institute. The Office of Internal Oversight Services believes that in cases where an institute is independent and apolitical, membership could be beneficial. Consequently, the Insurance Section would be able to determine industry benchmarks and monitor the broker's performance against these benchmarks. The Department of Management agreed to pursue this initiative.

III. Organization and resources

20. The Office of Internal Oversight Services believes that the Insurance Section is inappropriately structured and under-resourced. Firstly, the grouping of responsibilities for commercial insurance arrangements with the management of the health-insurance scheme for United Nations personnel under the auspices of one Section Chief is, in the view of the Office, not optimal. While both areas can be broadly categorized as concerned with insurance, health coverage pertains to the protection of individual staff members and involves a large amount of day-to-day administration, whereas commercial insurance involves protecting the interests and physical assets of the Organization.

21. The Insurance Section is currently located within the Office of Programme Planning Budget and Accounts, under the ultimate authority of the Controller. However, the Office of Internal Oversight Services views the establishment of commercial insurance coverage for property, casualty and third-party liability as predominantly a specialized procurement and contract management function requiring specialized expertise in identifying and assessing risks, defining coverage specifications and oversight of the brokers and underwriters contracted to protect the Organization from those risks. A small core of staff with experience and skills in insurance administration and contract management can undertake those tasks. The ultimate responsibility for those tasks should rest with the Assistant-Secretary-General for Central Support Services. The Office of Internal Oversight Services believes this complements the other functions of procurement, transportation and facilities management which are within the Office of Central Support Services.

22. In addition, the Office of Internal Oversight Services noted that the job description of the Chief of the Insurance Section specifies that the incumbent is required to spend only 35 per cent of his/her time on matters relating to commercial insurance. The bulk of the Chief's responsibilities relate to establishing policy and administering the claims and benefits of the health coverage. One P-2 Administrative Officer is also charged with administering the Organization's commercial coverage.

23. Given that the Organization's annual expenditures for commercial insurance coverage total approximately $7.12 million (including the annual premiums for global vehicle and cargo policies covered in a previous report of the Office of Internal Oversight Services), that the breadth of humanitarian and peacekeeping activities has expanded significantly over the last decade and that the field of proactive risk management has become more sophisticated, the Office of Internal Oversight Services believes that additional resources should be allotted to this function. *The Department of Management responded that these matters warranted "careful study by the Department".*

24. The auditors believe that lack of resources partially explains the over-reliance on brokers to represent the interests of the Organization and the reactive nature of the Section. Serious shortcomings in certain of the Organization's major commercial policies are discussed below. The Office of Internal Oversight Services attributes many of these problems to the weaknesses previously discussed in the Organization's approach to risk management.

IV. Foreign property coverage

25. The foreign property insurance policy currently provides coverage of United Nations property in Santiago, Addis Ababa, Kathmandu and Beirut valued at $222 million. This "all-risk" policy includes physical loss or damage, including earthquake, flood, boiler and machinery, but excludes terrorism, strikes, riots and commotion. The Office of Internal Oversight Services noted several areas that are cause for concern.

The assessment of risk

26. The broker had not performed a comprehensive risk assessment of any of the four property locations, nor could the broker show that such an assessment had been performed by the underwriters. The older United Nations premises in Addis Ababa and the premises of the Economic Commission for Latin America and the Caribbean (ECLAC) in Santiago had not been inspected by representatives of either the broker or the policy underwriters since the early 1980s. Only for the premises of UNDP in Nepal, had up-to-date details concerning the building construction and fire prevention features been sent to the underwriter.

27. In the case of the $106 million United Nations Conference Centre in Addis Ababa, constructed in 1995, neither the broker nor the Insurance Section could confirm whether the premises had been inspected for insurance purposes. They were both unaware that the underwriter had indeed inspected the premises just six months prior to the audit. Evidence of this inspection was only provided to the Office of Internal Oversight Services when the present report had already been finalized. Furthermore, the Insurance Section was not able to confirm what action had been taken to address the issues raised in the inspection.

28. Neither discussions with the broker nor a review of the annual renewal documentation revealed any kind of scientific assessment of the relative riskiness of the four properties in terms of the precise perils covered under the policies. There have been no known or reported losses since the inception of the policy in 1986. In 1997, the premium did decline relative to the value of the property covered, but this was attributed to the softness of the foreign property market as a whole.

The competitive bidding process

29. Although the contract was bid internationally, the Office of Internal Oversight Services believed that there was evidence to suggest that the bidding process was lax. In the renewal action plans for the last two bidding exercises the broker asserted that it would be "aggressively approaching other various domestic and foreign markets". The Office of Internal Oversight Services made the following observations:

(a) Of more than 50 markets that were contacted, 13 of the companies contacted had similar, if not identical, reasons for declination in both 1996 and 1997. Ten other companies did not respond in either year;

(b) Of 58 firms and affiliates approached in 1997, 16 were unable to submit a bid owing to the risk location and profile. Most respondents had declined to submit bids in previous years for the same reasons;

(c) In 1996, the firm submitting the lowest bid was later disregarded because the bid was based on property values from 1995. *The Department of Management stated that non-finalization of values at the start of the re-marketing exercise "has no bearing on the competitive process itself".* The Office of Internal Oversight Services does not regard this explanation as valid.

30. The Office of Internal Oversight Services also concluded that there had been very little broker competition in recent years. The foreign property insurance had been handled by the same broker since the policy's inception in 1986. In 1993 and 1994, the broker for the Headquarters property policy was also requested to submit a proposal for the foreign property programme. However, as shown by the minutes of the Headquarters Committee on Contracts, owing to the short time available, the broker was "unable to provide a quotation, but expressed willingness to pursue the matter at the next renewal if invited". In 1995, a broker competition exercise was deemed unnecessary in view of the previous results. Since then, there has been no attempt to foster broker competition.

31. *The Department of Management indicated that "a broker competition for a combined Headquarters and foreign property policy will be implemented this year".* The Office of Internal Oversight Services strongly urges that a wide range of different brokers be contacted to submit proposals.

The process of improving coverage

32. In 1997, the Insurance Section decided to double the primary coverage from $10 million to $20 million for the earthquake and flood components of the "all-risk" policy. In addition, coverage to protect the Organization in the event of a catastrophe causing more than $20 million worth of damage was also sought (excess coverage). The Office of Internal Oversight Services is concerned that neither the decision nor the underlying methodology were documented.

33. *The Department of Management informed the auditors that the competitive marketing exercise had been completed prior to the information that excess coverage might be obtainable. "The decision to capitalize on the opportunity to obtain meaningfully higher flood and earthquake cover was made as a prudent exercise of professional judgement."* However, the Office of Internal Oversight Services maintains that capacity within insurance markets does not change markedly from one week to the next. If obtaining additional coverage was considered a priority, then that should have been clearly reflected in the original request for proposals.

34. The Office of Internal Oversight Services believes that the Insurance Section should have first agreed with the broker on the aspects of coverage requiring improvement. Then, the process of determining acceptable coverage, selecting the underwriter and quantifying the additional premium for the excess coverage should have been properly monitored by the Insurance Section.

Common system benefits

35. The Office of Internal Oversight Services also wishes to point out that the current inclusion of the UNDP premises in Nepal under the foreign policy cover indicates that other common-system entities can benefit from the efficiencies of centralizing insurance administration and coverage. The cover obtained by the United Nations Security Coordinator for malicious acts committed at hardship duty stations is another effective example of one policy encompassing various organizations within the common system.

V. Headquarters property

36. The Headquarters property policy has been handled by the same broker since 1988. The contract was marketed on an international basis in 1989, 1992 and 1995. The risk is currently underwritten by a consortium of European-based insurance companies for a three-year period ending 30 September 1998. The Office of Internal Oversight Services found the bidding processes to have been conducted satisfactorily, however three main shortcomings in the overall programme were noted.

Methodology for determining asset values

37. The current insurable value of the United Nations premises at Headquarters, including the premises at 3-5 Sutton Place and 801 United Nations Plaza is $550 million. As far as the audit could ascertain, this value is essentially the original cost price plus the cost of any improvements or renovations since construction, plus an annual revaluation increment of 4 per cent. In the absence of a formal appraisal, the Office of Internal Oversight Services was not able to confirm whether the current insurable value was equivalent to the cost of replacing the building in the event of a catastrophe. While the auditors were assured that the percentage increment is in line with industry standards, no comparison of similar building structures in Manhattan has ever been made to verify the accuracy and reasonableness of the current insurable value. *The Department of Management stated that "we know of no way in which 'comparable' structures in Manhattan may be identified" to assist in this task.* The Office of Internal Oversight Services suggests that professional advice be sought on this matter, particularly in view of the General Assembly's recent request that "the Secretary-General should indicate in the next programme budget the value of United Nations-owned buildings" (resolution 52/220 of 22 December 1997, para. 104).

38. Concerning contents, representatives of the Facilities Management Division informed us that equipment was valued at original cost price ($135 million as at 1 October 1997). No depreciation factor is taken into consideration. In particular, the Office of Internal Oversight Services is concerned that the original cost price of the electronic data-processing equipment may frequently exceed the replacement cost, since the cost of such equipment tends to decline over time as a result of rapid technological advancements. In contrast, equipment belonging to UNDP, the United Nations Children's Fund (UNICEF) and the United Nations Population Fund (UNFPA) and insured under this policy, has been determined at the estimated replacement value. The Office of Internal Oversight Services believes that the annual insurance premium could be inflated, since the premium is calculated as a percentage of the overall valuation.

39. One trend that puzzled the auditors was that the value of the contents in the Secretariat complex has declined nearly 20 per cent, or $17 million, since 1995. In contrast, the equipment located in One United Nations Plaza has more than doubled in value over this time. *The Department of Management explained that these variations were due to "the introduction of a new and more sophisticated inventory system" in the Buildings Management Service. It also stated that the responsibility and competence in the area of inventory and valuation and management lies with the Facilities Management Division.* Nevertheless, the Office of Internal Oversight Services maintains that this division of responsibilities does not preclude the Insurance Section from providing general guidance as to what valuation methodology is needed for insurance purposes and verifying the accuracy of the values provided.

Responsibility for compliance with inspection reports

40. The Insurance Section was not aware of the status of corrective action taken to address the observations made by the main underwriter in the 1995 and 1997 inspections of the Headquarters premises. The Office of Internal Oversight Services also learned that the inspections did not include a review of security arrangements despite the fact that the "all-risk" policy includes protection against damage arising from terrorist acts.

41. Further, the Office of Internal Oversight Services noted that no particular individual, unit or office was responsible for addressing the problems identified and reporting back to the Insurance Section. Consequently, some of the observations made in 1995 were still evident in 1997. These include inadequate or insufficient sprinkler and smoke detection systems and storage of documents and paper too close to sprinklers. Clearly, these observations adversely affect the Organization's insurance risk profile and ultimately impact unfavourably on the premium level.

42. The Organization's programme budget for 1998–1999 foresees expenditures of $0.6 million to address deficiencies in the existing sprinkler and smoke detection system at Headquarters and to ensure compliance with local building regulations and safety codes. *The Department of Management stated that the remedial work was unlikely to have an appreciable impact on the insurance premium.* Nevertheless, the Office of Internal Oversight Services

considers that a concerted effort to address any shortcomings identified by the insurer is important. Since the inspection report is addressed to the Insurance Section, it has the responsibility to coordinate and oversee corrective action and to bring significant improvements to the attention of the underwriter.

Independent verification of the broker's financial well-being

43. The broker currently responsible for securing underwriters for the "all-risk" coverage of Headquarters property was not subject to a financial review prior to taking on the business in 1988. Upon request, the auditors were able to obtain a copy of the firm's most recent financial statements. While the Office of Internal Oversight Services is not questioning the financial viability of this particular broker, it believes that it should have been a prerequisite for the broker to prove its financial well-being at the time it first bid for the contract, and indeed again before each subsequent renewal period. *The Department of Management agreed to perform these checks in the future.*

VI. Demining liability policy

44. The Office of Internal Oversight Services has three main concerns with this policy: the absence of a risk assessment, the static level of the premiums and the lack of an overall policy protocol for demining insurance coverage.

45. In 1994, a demining programme in Mozambique, then under the auspices of the Department for Humanitarian Affairs, was initiated. In other countries where the Organization had been involved in demining efforts (Cambodia, Somalia and Afghanistan), the basic operating arrangement was that the respective Governments would take ultimate responsibility for the execution of the programme. The Governments in these instances effectively held the United Nations harmless against claims by third parties for personal injury or damage to property. In Mozambique, however, the training and demining itself was to be conducted by independent contractors holding special service agreements with the United Nations. The contractors were required to obtain their own insurance and the deminers themselves were to be compensated, in the event of injury, by a fund equivalent to the appendix "D" compensation scheme for work-related injuries suffered by Secretariat staff members.

46. The Office of Legal Affairs pointed out, however, that the arrangements did raise the spectre of "an unquantifiable, open-ended financial liability for the Organization" arising from damage and injury claims submitted by third parties. This exposure arose since the United Nations was ultimately responsible for the programme.

47. Consequently, the United Nations principal insurance broker was requested to seek proposals for coverage against potential liability claims from third parties. The broker identified a company willing to underwrite this risk for an annual premium of $66,000, and a contract was secured.

48. Since the inception of this coverage, the contract has been renewed three times, and the insurer has been paid a total of $280,000 in premiums. The programme was extended in 1997 to include the demining operations in Bosnia conducted on behalf of the International Tribunal for the Former Yugoslavia. The broker confirmed that no official approach to the markets has been made since mid-1994. To date, no losses have been reported in either location, and yet the premium level has not been revised, nor have the conditions and coverage afforded by the contract been altered.

49. While the very nature of demining makes it inherently risky, the Office of Internal Oversight Services is also concerned that an overall risk assessment was not conducted by the Insurance Section, the broker or the underwriter. The Section informed the broker from the outset that the project was felt "to involve virtually no third-party risks". Furthermore, the current Chief Technical Adviser for the project advised the auditors that once a given area was deemed free of mines, they could be approximately 99.6 per cent sure that that was indeed the case, owing to the rigorous techniques and quality control measures taken. Any complainant would be required to prove conclusively that the contractors had not complied with the minimum standards for demining as laid down in the United Nations Standards for Humanitarian Demining or the relevant host country standards.

50. In December 1997, the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-personnel Landmines was widely endorsed by most Member States. In addition, $500 million was pledged for assistance in demining activities. In view of the growing importance of demining activities for the United Nations, it is important that the appropriate operational protocol is achieved in order to minimize the Organization's exposure to the risk of third-party damage claims, at the same time avoiding a commitment to expensive insurance coverage when the actual operational risks are either ill-defined or, indeed, negligible.

VII. Aviation liability policy

51. The Office of Internal Oversight Services commends the initiative taken in 1997 to improve the Organization's protection against liability claims arising from aviation operations. All existing policies were rolled into one master policy covering contingent-owned, leased aircraft, as well as those provided under letters of assist. Previously, there was no coverage at all for the passengers aboard letters-of-assist aircraft. For a comparable premium level, the liability limit was negotiated up to $25 million, including coverage for non-United Nations, non-military passengers.

VIII. Headquarters liability self-insurance programme

52. The fund established to cover general liability claims made by third parties at Headquarters has reached a sufficient level to warrant examination of alternatives to the annual allocation from the regular budget of $200,000.

53. In accordance with General Assembly resolution 41/210 of 11 December 1986, the United Nations established the self-insurance plan as a result of drastic increases in the premium rates for liability coverage in the United States of America. In order to protect the Organization from massive tort claims, compensation for any non-economic loss, such as pain and suffering, is limited to $100,000.

54. At the time of the audit, the fund balance was $2,654,000. According to data provided by the Office of Legal Affairs, only $265,633 has been paid from this fund since its creation, of which $150,000 relates to the settlement of a single claim. Two other large claims were in arbitration at the time of the audit. The Office of Internal Oversight Services believes that, based on these figures, the continuation of the annual allocation at its current level does not appear necessary. While the Organization cannot rule out the possibility of a sizable claim being made some time in the future, 11 years of claims history shows that the settlement is likely to be relatively small as a proportion of the current fund balance. Furthermore, the United Nations is legally protected from the possibility of astronomical claims, owing to the cap on compensation for non-economic losses.

55. *The Department of Management concurs with the Office of Internal Oversight Services that an independent assessment of the fund is needed.* A prudent option may be to cease temporarily the annual allocation to the fund, but to take out an excess policy with a commercial underwriter to protect the Organization against claim settlements exceeding the current fund balance. Another alternative might simply be to suspend the annual allocation for several years, until such time as the fund balance needs an additional "top-up".

56. The Office of Internal Oversight Services also believes that a more proactive approach to accident prevention is needed in view of two recent accidents involving visitors to United Nations premises. A concurrent audit by the Office of Internal Oversight Services of the Organization's Security and Safety Service indicated that there were no formal policies and procedures for reducing the risk of accidents suffered by non-staff while on United Nations premises in New York. An analysis of the major claims is needed to identify areas of related risk. Restricting general access or improving signage in and around the premises could reduce the risk of sizable liability claims.

57. The self-insurance fund balance is invested by the United Nations Treasury based upon instructions from the Insurance Section. At the time of the audit, it was invested in three-month term deposits earning interest income at a rate of approximately of 5.75 per cent per annum. The Treasury is currently installing investment software that aims to make more lucrative returns for funds not needed for immediate cash flow. Approximately 75 per cent of the self-insurance fund balance has been identified as falling into that category. The Office of Internal Oversight Services endorses this initiative.

IX. Conclusions and recommendations

58. The Office of Internal Oversight Services believes that a more comprehensive, cohesive approach to managing risk is necessary. The Section responsible for commercial insurance needs to be restructured and provided with staff resources so that it can properly function as a central focal point for insurance and adequately oversee the work of the external brokers and underwriters. A risk assessment for the foreign property and demining liability policies is required, as are a method for valuing Headquarters property and a strategy for managing the self-insurance fund for liability claims. In particular, the Office of Internal Oversight Services makes the following recommendations:

- *Recommendation 1.* The Department of Management should promulgate a policy on risk management and distribute it to all offices away from Headquarters responsible for securing insurance coverage. The policy should include overall specifications and

guidelines for United Nations property policies worldwide. A comprehensive review of property losses should also be conducted prior to establishing an acceptable deductible level (AM/97/71/5/001);

- *Recommendation 2.* The Insurance Section should establish a binding contractual relationship with its brokers specifying service requirements. Terms could include requirements such as preparation of periodic stewardship reports, provision of financial position details and copies of the bid proposals to underwriters and disclosure of commission charges (AM/97/71/5/002);

- *Recommendation 3.* The Department of Management should consider transferring responsibility for commercial insurance arrangements to a specialized procurement and contract management unit within the Office of Central Support Services. In consultation with industry experts, the Department should include in the relevant job description the proactive responsibilities of a Risk Manager (AM/97/71/5/003);

- *Recommendation 4.* The Department of Management should consider assigning additional resources to establishing and monitoring commercial insurance arrangements, thus allowing the Insurance Section to improve its monitoring of brokers. For example, when seeking to broaden coverage, the rationale and method of determining new limits and the assessment of the proposals resulting from this initiative should be documented (AM/97/71/5/004);

- *Recommendation 5.* The Insurance Section should undertake a comprehensive broker competition exercise prior to the combination of Headquarters and foreign property policies and ensure that action is taken to correct any outstanding deficiencies on the premises, as identified by previous inspections. The selected broker should perform a risk assessment of the foreign property programme (AM/97/71/5/005);

- *Recommendation 6.* The Insurance Section should provide general guidelines to the Facilities Management Division concerning the valuation requirements for insurance purposes. Variations in total value of more than 10 per cent between years should be adequately explained by the Division (AM/97/71/5/006);

- *Recommendation 7.* The Insurance Section should seek advice from insurance industry sources on an acceptable method for determining the replacement cost of electronic data-processing equipment. While the cost of a formal appraisal of the building may prove prohibitive, the Office of Internal Oversight Services suggests seeking professional advice on methods of determining the insurable value of the Headquarters premises (AM/97/71/5/007);

- *Recommendation 8.* The Insurance Section should arrange for a comprehensive presentation on Headquarters security arrangements for the underwriter at the time of the next insurance inspection (AM/97/71/5/008);

- *Recommendation 9.* The Insurance Section should establish an implementation or reporting timetable with the Security and Safety Service and the Facilities Management Division for implementation of the recommendations resulting from the underwriter's inspection. Compliance with the recommendations should be promptly communicated to the broker (AM/97/71/5/009);

- *Recommendation 10.* The Insurance Section, in conjunction with the Mine Action Services Centre, Department of Peacekeeping Operations, should perform a risk assessment of those demining activities for which the Organization is responsible. Formal guidelines on the various risks and insurance implications arising out of different operating modalities for demining should also be established so that the Organization's future exposure to liability is minimized (AM/97/71/5/010);

- *Recommendation 11.* Based on the outcome of the assessment, the Insurance Section, through the selected broker, should seek proposals from underwriters to provide continued insurance coverage for the demining activities concerned to determine whether similar or improved cover is available at a lower cost (AM/97/71/5/011);

- *Recommendation 12.* The Department of Management should seek an independent assessment of the self-insurance fund and then decide whether to continue the annual allocation at present levels or obtain excess cover in the commercial market (AM/97/71/5/012);

- *Recommendation 13.* The Office of Legal Affairs should advise Headquarters Security and Safety Service of the magnitude and seriousness of recent third-party claims. The Service should then implement measures to reduce the risk of accidents (AM/97/71/5/013).

59. *The Department of Management's response to the above recommendations was largely positive. The*

Department agreed to implement recommendations 1, 2, 11 and 12. In other instances, the Department "shared the thrust of the recommendation", without specifying, however, the course of action to be taken or the coordination efforts undertaken within the Secretariat (recommendations 5, 8, 9, 10 and 13). Concerning organizational structure, resource allocation and redefinition of responsibilities (recommendations 3 and 4), the Department stated that the recommendations warranted careful study. The Office of Internal Oversight Services expects that the Department will carry out this study without delay. *On the issue of valuation methodology (recommendations 6 and 7), the Department emphasized that responsibility for establishing accurate property valuations for insurance purposes lies with the Facilities Management Division. It agreed, however, that this Division should work "in close consultation with the Insurance Section".*

60. The Office of Internal Oversight Services anticipates that implementation of all of the recommendations would enable the Organization to manage its exposure to external risks in a more proactive and efficient manner. The Office of Internal Oversight Services will closely monitor the implementation of all recommendations.

(*Signed*) Karl Th. **Paschke**
Under-Secretary-General
for Internal Oversight Services